Estate of Mary Margaret Murphy, Deceased, John Falk Murphy, Personal Representative, Petitioner v. Commissioner of Internal Revenue, Respondent, 71 T. C. 671 (1979)

The rule against perpetuities for interests appointed under a special power is computed from the creation of the power, not its exercise, under Wisconsin law.

Summary

Mary Margaret Murphy exercised a special power of appointment by creating a second power in her husband, John, to appoint trust property to their lineal issue. The IRS argued that this exercise should be included in her estate under IRC section 2041(a)(3), which taxes the exercise of a power that creates another power validly exercisable to postpone vesting or suspend ownership without regard to the first power's creation date. The Tax Court held that since Wisconsin's rule against perpetuities measures the permissible period from the creation of the first power, section 2041(a)(3) did not apply. This decision clarifies that the applicability of section 2041(a)(3) depends on the specific formulation of the state's rule against perpetuities.

Facts

Ross W. Harris created a trust for his wife and daughters, including Mary Margaret Murphy, giving them life income interests and special testamentary powers of appointment over their shares. Upon Mary's death, she exercised her power by appointing her share to a new trust (MMM Family Trust) and giving her husband, John, a special power to appoint the trust's corpus to their lineal issue. John later renounced this power. The IRS sought to include the value of the appointed property in Mary's estate under IRC section 2041(a)(3).

Procedural History

The IRS issued a notice of deficiency to Mary's estate, claiming a tax on the value of the property subject to her power of appointment. The estate petitioned the U. S. Tax Court for relief, arguing that section 2041(a)(3) did not apply under Wisconsin's rule against perpetuities.

Issue(s)

1. Whether the exercise of a special power of appointment by creating a second power of appointment is taxable under IRC section 2041(a)(3) when the applicable state's rule against perpetuities is measured from the creation of the first power.

Holding

1. No, because under Wisconsin's rule against perpetuities, the permissible period for an interest appointed under a special power is computed from the date of the

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power’s creation, not its exercise. Therefore, section 2041(a)(3) does not apply.

Court’s Reasoning

The court analyzed the language and purpose of section 2041(a)(3), which was enacted to tax the exercise of powers of appointment that could lead to indefinite postponement of vesting or suspension of ownership under certain state laws. The court emphasized that the statute’s applicability depends on the local rule against perpetuities. In Wisconsin, the rule is expressed in terms of suspension of the power of alienation, and the permissible period is measured from the creation of the first power. The court rejected the IRS’s argument that the statute should be read literally to apply to any of the three conditions of title (postponement of vesting, suspension of ownership, or power of alienation) without regard to the state’s specific rule. The court found support for its interpretation in the legislative history and regulations, which indicate that the statute was aimed at states like Delaware, where the perpetuities period is computed from the exercise of the power. The court also noted that a contrary interpretation would impose one state’s rule against perpetuities on others, contrary to the evolution of state property law.

Practical Implications

This decision clarifies that the applicability of IRC section 2041(a)(3) depends on the specific formulation of the state’s rule against perpetuities. Estate planners must carefully consider the local rule when drafting powers of appointment, especially in states like Wisconsin that measure the permissible period from the creation of the power. The decision also highlights the importance of understanding the nuances of state property law when dealing with federal tax issues. Subsequent cases have followed this reasoning, and the 1976 generation-skipping transfer tax provisions may have indirectly addressed the IRS’s concerns about potential abuse. This case serves as a reminder that federal tax law often interacts with state property law in complex ways, requiring careful analysis of both.

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